A Guide to Commercial Finance.

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BY

ALFRED G. DEACON & CO.
CHARTERED ACCOUNTANTS,
MANCHESTER AND LEICESTER.

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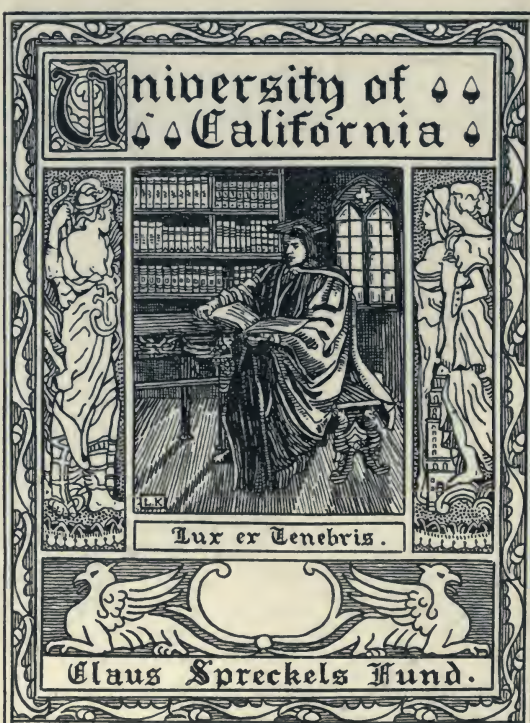
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PREFACE.

THE purpose of this Book is to present in general, and, it is to be hoped, interesting terms, some of the topics that frequently come under the notice of business men; topics that, perhaps, may be of assistance both to those who are obtaining benefits through having their businesses already organised on up-to-date lines, and to those others who are endeavouring to secure those benefits.

We have taken it for granted (and it seems too late in the day to do otherwise) that the reader admits that Finance and General Organisation are imperative in the successful running of a business; that these are, in fact, the keynotes of success. The large number of unsuccessful undertakings, through not recognising this fact, demonstrates the truth of our assertion.

This book has not been written to particularise any class of business, nor has it been written as a text book for students; but it has been our endeavour to submit and enlarge upon principles that appertain to nearly all businesses, and which, we consider, work out the most successfully.

The views stated herein are the outcome of our experience in connection with well-organised and properly-managed concerns. In a work of this

description, it is, of course, quite impossible to consider all details of business affairs, but many of the most important features are dealt with in a manner as concise as possible, considering the nature of the particular subject under review. Conditions and contingencies in connection with business affairs are constantly changing, but the observations herein contained will, we hope, be instrumental in aiding the establishment or furthering the improvement of businesses on sound financial lines, and assist in avoiding the many pitfalls which we, as Accountants, observe from time to time.

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September 1910.

And at LEICESTER.

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A GUIDE TO COMMERCIAL FINANCE.

CHAPTER I.

"PRINCIPLES OF FINANCE."

One of the most important matters in connection with the organisation and successful conduct of a business is that all the salient points of the business should be placed before the principal regularly. These should be summarised and tabulated in such a form that the principal can supervise and direct every department of the concern. The matters for his consideration include the results of the firm's trading both in total and the detail from departments; how such results have been arrived at; and whether better results can possibly be obtained by any alteration and improvement in the working of the business.

Briefly, the main points to be closely watched are :—

1. Is the turnover increasing ?
2. Is the rate of gross profit maintained ?
3. Are the expenses increasing out of proportion to the turnover ?
4. Is the net profit on the turnover and the capital employed adequate ?
5. Is the cash position sound ?
6. Does the balance sheet show a satisfactory state of affairs ?

These points are dealt with separately in the six next succeeding chapters.

CHAPTER II.

"TURNOVER."

Turnover or sales being the pivot on which the whole business depends, the statistics in connection with trading results are based upon it. Thus it is seen that every conceivable method is adopted to secure the largest possible turnover, as, for example, by advertising, canvassing, allowing of credit, quality, warranties, cheapness of production, standardising by trade marks, etc., etc.

It will therefore be apparent that, unless the turnover is maintained, the percentages of fixed expenses, viz., rent, rates, etc., must increase. Consequently, it is of the utmost importance that the sales should be periodically examined, say at least once a month, in order to ascertain whether the net turnover (*i.e.*, gross sales, less returns and allowances) shows an increase or decrease as compared with the corresponding period in the two previous years. In some businesses climatic conditions materially affect the turnover, as, for example, in umbrella, mackintosh, or drapery

businesses, where the turnover is influenced by the weather; it is therefore advisable for firms engaged in such businesses to base their expenses on an *average* turnover, as well as to make comparisons with previous years. For instance, it would not be prudent for a manufacturer of mackintoshes to spend in accordance with his earnings in a rainy season.

At the commencement of the financial year an estimated amount of turnover for the current year may be assumed, based on the average turnover of the three previous years' trading. For example, assume that the average turnover per annum was £40,000, showing a gross profit of 25 per cent (£25 for every £100 of turnover), viz., £10,000; and on this turnover the percentages of material, labour, and expenses appear as follows:—

Raw material	£52	out of	every	£100	of	turnover.
Wages—Productive ...	£16	,,	,,	,,	,,	,,
Carriage	£3	,,	,,	,,	,,	,,
Motive power	£2	,,	,,	,,	,,	
Packing	£2	,,	,,	,,	,,	,,
Cost of production ... (Leaving for gross profit £25 out of each £100 of turnover.)	£75	,,	,,	,,	,,	,,

Add fixed expenses (rent, rates, etc.)	£5	out of every £100 of turnover.
Fluctuating expenses ...	£10	" " " " "
Total cost	£90	" " " " "
Leaving for interest on capital and net profits	£10	" " " " "
	£100	

In connection with this statement of the total cost (90 per cent), it may be pointed out that all the items fluctuate in proportion to the turnover, with the exception of the fixed expenses, which are five per cent on £40,000, viz., £2000; and, although on an increased turnover such fixed expenses remain stationary to a point, yet afterwards there is a tendency for them to increase until a further additional turnover is reached. For the purpose of argument, however, let it be assumed that the turnover is increased in the following year by £20,000, and the fixed expenses remain the same, that is, £2000. This will show a percentage of fixed expenses (£2000) on the turnover (£60,000) of £3. 6*s.* 8*d.* on each £100 of turnover; thus the total cost, including expenses, is decreased by the difference between £3. 6*s.* 8*d.* per cent and £5 per cent, and accordingly the net

profit is increased from £10 to £11. 13*s.* 4*d.* per £100 of turnover. In this connection the turnover and position of the business at this stage affords an opportunity of the question being considered of reducing the rate of gross profit by a reduction of the selling prices to the customers, which might be advantageous to the business and result in a still further increase in turnover.

During periods of depression in trade some businesses experience more difficulty than others in altering their organisation to meet the changed conditions consequent upon a contraction in turnover, and, *vice versa*, in times of good trade to meet the expansion in turnover, owing to the fact that the fixed charges are high in proportion to the turnover, and if the firm's machinery is running, or there is any business being done, practically the whole of the fixed charges are being incurred. For example, such concerns as railways and theatres: these are dependant on an output or turnover above normal in order to meet their fixed expenses, which are being incurred whether the output or turnover is below or above normal. On the other hand, in other businesses such depression in trade can be met by a reduction

of expenses; as, for instance, in the engineering trade, where the number of employees may be reduced.

When times are bad, it is an advantage for a business to be able to contract or curtail expenses rapidly; but a business that cannot quickly curtail its expenses has the advantage in prosperous times, for the total cost of production with them does not increase, as it of necessity does in businesses that can contract or expand their expenses rapidly.

CHAPTER III.

"GROSS PROFIT."

Gross profit in manufacturing concerns is the difference between the cost of production to the manufacturer and the selling price to the customer. The cost of production is comprised of the cost of the raw material and carriage, and the cost of labour and motive power expended in the production.

Gross profit in a merchant's business is the difference between the cost price of goods to the merchant and the price at which he sells the goods to the customer.

It is important that the gross profit be ascertained frequently, and that the books be kept on such a system that this can be easily done.

The percentage of gross profit in proportion to turnover varies in different classes of businesses, and even in a particular class of business may vary from one year to another, owing, perhaps, to an alteration in the internal organisation of the

business, or owing to extraneous matters, such as the demand and supply of an article, which regulate the purchase price and sale price of it. Frequently an advance in the price paid for raw material by the manufacturer cannot be obtained in full from the customer purchasing the finished article, and on a rising market the manufacturer cannot always obtain from the buyer the full amount of the increased cost, but this loss to the manufacturer is often averaged by him and made up on a falling market, when he can buy the raw material cheaper from day to day, whilst the cost of the finished article to the buyer does not decrease with the same rapidity.

The results of these rises and falls should be averaged over a period of years, but the information that the manufacturer or merchant must have is: "What is the rate of gross profit that must be obtained, below which the business cannot be successful?"

The questions of buying, selling, factory organisation, etc., are important, and require careful attention, as the cost of production has a tendency to increase, which means that the rate of gross profit will decrease. This is more especially

noticeable during a period of trade depression, when there are fewer orders to be executed, and consequently the employees spend more time than is actually necessary on production, and more than they would spend if trade were brisk and further work were awaiting execution.

It would perhaps be advisable at this juncture to point out that it is the invariable custom for business men to base the percentages of gross profits upon the selling price of the goods and not upon the cost price. No hard and fast rule can be laid down as to what rate of gross profit a particular class of business should make, so much depends upon the kind of business done, the class of customer, the locality of the business, or the reputation of the firm for quality, etc.

Where the turnover is large, both as regards bulk and cash values, where there are sharp clearances of stock, and where the payment of cash is made quickly, the rate of gross profit is generally low, whilst in the case of novelties, luxuries, patented articles, etc., or where long credit is given, the rate of gross profit made is usually high.

The question to be answered is: What is the normal rate of gross profit that should be expected? If the expected gross profit is not shown as a result of the trading, it is important that the reason of this should be enquired into. In such a case the answers to the following queries may aid in the solution:—

1. Is the buying department responsible?
2. Have the fixed selling prices been adhered to?
3. Has value been received for all payments made?
4. Has any of the stock been taken by theft?
5. Have stocks been allowed to become old and out of date?
6. Have all goods sold been accounted for in cash or credit?

Where differences in gross profit occur, it is desirable to test a day's sales from time to time, taking each transaction separately to ascertain exactly whether the difference between the cost price and selling price of the goods sold is as anticipated, in other words, whether the rate of gross profit is being maintained.

CHAPTER IV.

"EXPENSES."

The expenses of a business are generally divided under two main heads:—

(1) Expenses of production;
(2) Expenses on distribution.

The first of these has already been dealt with in Chapters II. and III. The expenses on distribution are subdivided into fixed and floating. Examples of fixed expenses are rent, rates, gas, insurance, manager's salary, etc.; and examples of floating expenses are travellers' commission, stationery, postages, discount, bad debts, etc. The floating (or fluctuating) expenses are those which vary rateably with the turnover, *e.g.*, discounts may be three per cent of a turnover of £20,000. If the turnover is double that amount, the amount of expense on discount account is likely to be double also, thus the percentage would still remain at three per cent. The rate per cent of the expenses on the turnover requires to be carefully watched, as, should a certain expense show a tendency to increase in percentage, the details of such expense should be examined to see if any economy on that account can be effected.

The trading and profit and loss account should be prepared in such form that the percentage of each class of expense, when ascertained, can be compared with previous years, so that it may be readily seen as to whether the percentage of any expense has increased. As stated previously, the percentage of these expenses is in each case based upon the turnover.

The form for comparison of percentage of expenses on turnover is as follows:—

	1907	1908	1909
Purchases	55·00	54·22	53·43
Carriage, etc. ...	·11	·20	·18
Packing	·21	·19	·22
Wages	18·66	19·22	19·40
Salaries and Commission ...	8·42	8·31	9·93
Rent, Rates, Taxes, Gas, Water, etc.	1·88	1·91	1·90
Travelling Expenses	·70	·64	·82
Insurance	·12	·14	·18
Advertising	1·40	1·52	1·01
Incidentals	1·67	1·89	2·31
Discount on Sales...	3·21	3·13	3·40
Bad Debts	1·62	2·10	1·87
	93·00	93·47	94·65
Net Profit	7·00	6·53	5·35
	100·00	100·00	100·00

Thus it will be seen at a glance that in 1909 the net profit is lower in percentage than in the two previous years, having decreased to 5·35 per cent on the turnover. On making a comparison of the cost of production and percentage of expenses, it will be seen that the decreased net profit is due to the increase in salaries and commission account, and that the cost of production is actually less than in the two preceding years. In a case like this, the reason of the increase in this item of expense would be closely enquired into, as the result is that over £1 profit for every £100 worth of sales has been lost. Such an enquiry might show that the firm is overstaffed in non-productive departments, and possibly, as the result of such enquiry, economies therein might be wisely effected.

CHAPTER V.

"NET PROFIT."

Net profit is the object for which the business has been undertaken or the company floated. The value of a business depends to a great extent upon the net profit; also the value of the assets are in a large measure based upon net profit. This aspect is further dealt with in Chapter VII. on "Capital."

The percentages of net profits on the turnover and on the capital employed should be ascertained to see that the returns thereon are adequate.

CHAPTER VI.

"Cash Position."

The maintenance of a sound cash position is imperative. It can be readily understood that a manufacturer or merchant, having unquestionable abilities as a salesman, finds it a great hardship when his cash position will not permit him to extend his business either by increasing his sales or in enlarging his premises, and it is just at this juncture that the utmost care should be taken that the limit of his credit and cash resources be not overreached in the search for turnover. This overreaching of one's resources may be caused by an increase in the fixed assets, *e.g.*, machinery, or increase in amounts owing from customers, or the accumulation of stock not conveniently realisable at a profit when cash is most urgently needed. Assets which do not produce income should be kept at a minimum, as, for example, a debt owing to the firm that is overdue, or additions to fixtures.

Frequently firms that have during their existence made profits, have eventually had to admit

failure, owing to their neglecting to watch their cash position; these firms might have been assured of continued and further success had the importance of this matter been fully realised by them.

On the other hand, it is not always advisable for a man to leave a surplus of cash that is not presently required in his business, as such surplus cash creates a tendency to slackness in the business, whereas the withdrawal of the surplus cash results in a tightening of the cash position, and as a consequence the latter is more closely watched.

This subject is further dealt with in Chapter VII. on "Balance Sheet."

CHAPTER VII.

"BALANCE SHEET."

The scrutiny of the balance sheet is of the utmost importance, for on it is shown the amount of capital embarked in the business, whether such capital is increasing or decreasing, and how such capital has been sunk in assets. It also reveals the cash position, liabilities, fixed assets (such as properties, goodwill, etc.), and the floating assets (such as debtors, stock, cash, etc.) of the firm.

The division of assets and liabilities should be detailed as much as possible.

A close examination of the various assets shown on the balance sheet should be made, and compared with the corresponding items in previous balance sheets. For the purpose of making this clearer, a comparison of the balance sheets for three

years of an assumed private partnership business is shown below :—

BALANCE SHEETS. 31st DECEMBER 1906, 1907, and 1908.

LIABILITIES.	1906	1907	1908	ASSETS.	1906	1907	1908
	£	£	£		£	£	£
Mortgage on Property at 4 per cent ...	2,000	2,000	2,000	Property ...	3,500	3,400	3,300
Loans at 6 per cent	1,000	1,400	800	Machinery ...	6,000	6,150	6,200
Creditors ...	3,650	4,700	4,400	Furniture ...	300	270	240
Bank Overdraft	3,250	3,980	3,770	Goodwill ...	4,000	4,000	4,000
Capital Account :—				Trade Marks and Patents	1,200	1,500	1,700
A	6,500	6,825	7,150	Debtors for Goods ...	4,070	5,280	5 ,200
B	6,500	6,825	7,150	Debtors for Loans... ...	500	1,000	550
				Stock	3,300	4,100	4,050
				Cash	30	30	30
£	22,900	25,730	25,270	£	22,900	25,730	25,270
Turnover for year ...	£30,000	35,000	32,000				
Net Profit ...	£1,000	1,200	1,000				

It is assumed that the normal condition of the business is as shown at the end of 1906, when the turnover was £30,000 and the gross assets £22,900. In 1907 and 1908 the turnover was

£35,000 and £32,000, and the gross assets £25,730 and £25,270 respectively.

Each item of the balance sheet should be taken separately and criticised in manner following :—

ASSETS.

PROPERTY.—The firm owns its own premises and has kept the property in repair out of revenue, and has written off about three per cent per annum on the value of the property. Depreciation of such an asset tends to strengthen the cash position and provides a reserve for additions in the future. The property should be insured against fire. Presumably, the mortgagees hold the policies for the loan of £2000, which appears to be nearly two-thirds of the value of the property, and is the usual proportion of one to the other.

MACHINERY.—The machinery shows a net increase of £150 in 1907. This may be owing to additions having been necessary in order to cope with the increased turnover, costing perhaps £500, and depreciation may have been written off of £350, thus increasing this asset by £150. This of course seems quite reasonable in view of the extra

business, and is satisfactory so long as the cash can be easily raised for the cost of the additions. In this case six per cent has to be paid for an extra loan of £400, and it is for the principals to decide whether it is advantageous to extend the sales by increasing the machinery, and yet at the same time incurring the liability of a loan. Here the result in the increased net profits for 1907 justifies the additional expense on machinery. In 1908, however, the net additions to machinery have been increased by a further £50, but the turnover shows a decrease as compared with 1907, so that this cannot be considered altogether satisfactory. The results for 1908 show that it is taking a greater value of machinery in 1908 than in 1906 to make the same amount of net profit.

The rate of depreciation on machinery varies, generally it is about 5 per cent, $7\frac{1}{2}$ per cent, or 10 per cent per annum. In settling the rate, consideration must be made for wear and tear, obsolescence, day and night running, amount expended on repairs and renewals, etc. It is advisable that the machinery be revalued from time to time to ascertain that the depreciation written off is adequate. One particular point that should be borne in mind where a large percentage

of depreciation on machinery is being written off, however, is, that when a claim for damage by fire might arise, the insurers might only agree to assess damages at the book value of the machinery, which, in consequence of considerable writing down, may be much lower than the actual value, in which case the desirability of such writing down of the machinery may be questioned, for the result would hardly be advantageous to the concern.

FURNITURE.—In the sample balance sheet comparison above, this asset has been reduced each year at the rate of ten per cent per annum on the original value, and this reduction may be considered to be satisfactory.

GOODWILL.—The value of the goodwill (£4000) remains at the same figure each year. Goodwill is of course purely a "paper asset," and depends almost entirely on the net profits of the firm. Goodwill must not be appreciated from year to year, and it is not customary to decrease the same by writing an amount off against revenue. If it is desired to create a reserve against this asset, it is preferable to write an amount off profits to a

reserve account, and this would be shown on the liabilities side of the balance sheet. Goodwill is further dealt with in Chapter XI.

TRADE MARKS, PATENTS.—The possession of assets such as these represent is often of great value to a firm, but unless the net profits of the firm are increasing it is distinctly inadvisable that the amount of this account should be increased. In this case, comparisons over the period of three years show that these assets have increased by £500; this is not satisfactory, having regard to the fact that the profits have not increased proportionately. The value can only be judged by results. Care should be taken that these assets are systematically written down out of profits, as, if this is not done, the result may be the weakening of the cash position by the sinking of capital in unremunerative fixed assets.

DEBTORS FOR GOODS.—This asset represents the total of the amounts owing to the firm from customers, less any reserves for bad or doubtful debts, and for discounts and allowances that will have to be allowed. Debts are termed "floating" or "liquid" assets, and in fact are more likely to

fluctuate with the turnover than any other of the assets of a firm. In the example shown, the net value of the debts in 1906 was £4070, and the turnover for that year £30,000. The proportion of one to the other is as 1 to $7\frac{1}{2}$. By dividing 52 weeks by $7\frac{1}{2}$ the result is approximately seven weeks, which is the average length of credit allowed to customers. The principals might consider this satisfactory in total. In the following year (1907) it will be seen that the debts have been increased to £5280 on a turnover of £35,000. This works out at about eight weeks' credit, and as the tendency during 1907 has been for credit allowed to customers to increase, the customers' accounts should be frequently examined, in order to avoid if possible the locking up of cash in outstanding debts, for in 1907 the debts are about £500 more than normal.

Again in 1908 the position of affairs is still more unsatisfactory, as the debts remain practically the same as at 1907, but the turnover has decreased by £3000, resulting in an average credit allowed of nearly nine weeks. In such a case the matter requires serious consideration, as it is possible that the reason is that debts are becoming

bad through not being dealt with, or that, owing to bad trade, less profits can be made and more credit has to be given. Whatever the cause, however, the question demands careful and immediate handling, otherwise the cash position may become so seriously cramped as not to allow for expansion of business when this becomes desirable. For the purpose of criticism and comparison, bills receivable and bills discounted should be treated as debtors until such time as the bills are actually met. Renewals of bills need to be carefully watched, so that loss of interest and the possibilities of bad debts may be avoided. The question of credit is dealt with at further length in Chapter IX.

Debtors for Loans.—This asset will probably represent advances made to customers for the purpose of financing them in their businesses. Care should be taken not to let this item increase unduly, also to see that the interest thereon is collected regularly. The amount of the loan will possibly vary according to the amount of business the customer does with the firm.

Stock.—Like debtors, this asset is one which fluctuates with the turnover, and, in order to be satisfactory, should increase or decrease proportion-

ately with the turnover. The same observations made with respect to debtors apply as regards the increases in the assets for 1907 and 1908, *i.e.*, that in the illustration 1907 may be considered fairly satisfactory, but 1908 unsatisfactory. When stock is taken, it should be valued either at cost or market price, whichever is the lower, subject to any advisable reserves. As with the valuing of machinery so with the valuing of stock, it should be noted that, if the same is valued on too low a basis, the possibilities in case of a fire are that the firm will suffer in a settlement with the insurers, as in all probability the only method of arriving at the value of the stock destroyed is by reference to the books, which in such a case would show the stock at a figure lower than the actual value. Needless to say, the stocks should be always up to date, and the question often arises as to whether buying as it is required, or on contract, is the more satisfactory. Traders generally agree that, considered over a period of years, there is little to choose between the two systems. Another important point is as to the number of times the stock should be turned over, for it is inadvisable to lock up more capital in stock than is absolutely necessary, as, in addition to the depreciation of the stocks and

the consequent losses, there is the loss of interest on the cash put into stock to be considered. The smaller the gross profit, the greater number of times the stock should be turned over, whilst the greater the gross profit the less the number of times the stock is turned over. The method of arriving at the number of times the stock is turned over is as follows: In the example above, the stock for the year 1906 is £3300, and the turnover £30,000. Assume that the rate of gross profit in proportion to turnover be ten per cent, the cost price of goods (*i.e.*, raw material and labour) sold would be £27,000 (*i.e.*, £30,000 less ten per cent = £3000). The division of stock, £3300, into this amount is roughly eight. Therefore the stock in 1906 was turned over approximately eight times, and this on a gross profit of ten per cent may be considered satisfactory. Where capital invested in stock is turned over a fewer number of times, the gross profit should be greater. Thus, where stock is only turned over once or twice a year, the gross profit should be approximately 40 to 50 per cent or perhaps more. Where stock is turned over three times, the gross profit should be approximately 25 per cent; four times, 20 per cent; and so on.

LIABILITIES.

Loans, Mortgages, and Bank Overdrafts.—With regard to these liabilities, it is advisable that arrangements be made for the repayment of same by instalments, as there is always the possibility existing that immediate payment may be demanded, which may cause great inconvenience to the business, and not infrequently result in the firm suspending payment.

In dealing with a banker, great care should be exercised not to obtain too large an overdraft, as experience has shown this mistake to be the cause of many firms having to restrict their trading. In any case where a trader is reminded by his banker that his overdraft is getting too large or is extending to an amount greater than the bank are prepared to give, he should seriously consider his position, as he then stands in a similar position to that of a customer who is informed by a creditor that the latter is not willing to allow him any further credit. There are so many contingencies that arise in connection with a bank overdraft. Should the overdraft be granted when the value of money is low, there is always the possibility of

the overdraft having to be reduced when the value of money increases, and this often proves to be the most awkward time for a reduction. There are many reasons why a request for the reduction of an overdraft might be made. The following are a few of such :—

1. An unfavourable balance sheet might be presented to the banker, even although such unfavourable balance sheet be the direct result of the high price of raw material which the merchant has been unable to recover from his customer.

2. Perhaps a new bank manager is appointed who will have a different opinion of the firm than the former manager, or who will not know of any special contingencies in connection with the firm that weighed with the former manager.

3. An accident might occur at a firm which might effect the firm's stability.

4. A director of the firm might retire, or the death might occur of one of the partners, which might affect the goodwill and credit of the firm.

5. The bank might consider that the risk of loss by fire cannot be totally covered by insurance.

These and many other reasons may be sufficient in themselves to justify the bank in demanding a reduction. Mention is made of these to show the reason why the utmost care should be exercised in borrowing money from any source where the conditions for repayment cannot be arranged; thus, in the case of mortgages, it will be found that, usually, there is only three months' notice required to be given for the repayment of the mortgage to be made. Unless a firm has substantial reserve funds available in cash, or is able to quickly replace a mortgage by another one, it will be readily seen that the difficulty is rather serious, as the mortgagee may, under his powers, sell the property, which course may be quite the reverse of advantageous to the firm.

There are some insurance companies who lend money on mortgage securities, and at the same time issue a redemption policy whereby a fixed annual premium is paid to the insurance company until such time as the premiums and interest thereon are sufficient to pay off the

mortgage. Such premiums are paid out of cash as part of the profits not divided, so this method operates in the same manner as a sinking fund.

Creditors.—The question of the credit obtainable from firms from whom purchases are made is an important factor in any business, and is valuable in almost the same way as a loan of money for the purpose of financing a business is valuable. The total credit allowed usually varies according to the turnover. If credit has a tendency to increase disproportionately it will generally be found that the profits are lower, owing to loss of discounts by reason of such extended credit.

In the stages from the manufacture to the selling of an article, the length of credit increases in each stage from the commencement of the process of manufacture in the form of raw material until the time the article is sold to the consumer. Thus, the nearer the stage in the process of manufacture to raw material the shorter is the credit allowed, and it is generally found that the longest credit in business is given by wholesalers to retailers, as the keen competition for the retailers' trade has made this lengthened credit a custom of trade. The retailer considers he is justified in asking for this

credit, as he is often compelled to hold goods some considerable time before they can be converted into money. See Chapter IX. on "Credit."

CAPITAL.—Where a business is owned by a sole trader, or by partners, the capital represents the difference between the assets and liabilities, and appears on the liabilities side of the balance sheet, being, in fact, a liability due from the firm as a seperate entity to the proprietor, or partners, as the case may be. The net profits of the business are added to the capital account, and the withdrawals on account of income and capital are deducted from the capital account. It is advisable to watch the fluctuations of this account in order to immediately detect any material decrease. In the case of a limited liability company, the capital of the concern is shown separately from the profits. The latter appear under the heading of profit and loss account or reserve fund, and are shown separately from capital in order that the amount available for dividend may be seen at a glance. If part of such profits remains undivided, a portion of the company's cash balance, that is not immediately required for the purpose of carrying on the business, is sometimes invested in securities

outside the business. These securities should be so arranged as to be readily realisable should circumstances, such as the renewal of a wasting asset or the redemption of a loan, demand it.

The value of a business depends to a great extent upon the net profits. For instance, in the form of balance sheet on page 19 the total assets in 1907 were £25,730 and the net profit £1200, or a percentage of £4. 14*s.* 0*d.* (4·7 per cent). In the following year the total assets were £25,270 and the net profit £1000, showing a percentage of £3. 18*s.* 0*d.* (3·9 per cent). It will be readily seen that the capital value of the concern has decreased, owing to the fact that a greater working capital would be required to make the same amount of profit. The capital that should be required in 1908 (at the same ratio of profits to capital as in 1907) is £21,440, whereas it was actually £25,270; therefore the capital value of the concern has decreased £3830.

CHAPTER VIII.

"MONTHLY RETURNS."

In addition to the scrutiny of all figures, comparisons, etc., in connection with half-yearly or annual accounts referred to in previous chapters, most firms making any pretence at organisation submit to their principals or directors, at least once a month, a summary of the results of the trading for the previous month, together with the figures for comparison of the corresponding period in the previous years. These figures and statistics are kept in a monthly summary book. The form of keeping this book would, of course, vary in different businesses, but the following will give a general idea of the system :—

TURNOVER.

	1907	1908	1909
January	1,989	2,227	2,350
February ...	1,600	1,428	1,620
March	2,001	2,150	2,530
etc.			

These columns may be sub-divided for cash and credit sales.

DEBTORS.

	1907	1908	1909
January	3,009	4,890	4,320
February ...	2,905	4,161	3,935
March	3,682	4,230	4,540
etc.			

CREDITORS.

	1907.	1908.	1909.
January			
February			
March			
etc.			

Bank Position.

	1907.	1908.	1909.
January			
February			
March			
etc.			

Show figures of an overdraft in red ink and of a balance in black ink.

Stock.

	1907.	1908.	1909.
January			
February			
March			
etc.			

Turnover.—The turnover or net sales would of course be procured from the various sales day books for credit sales, and from the cash book, etc., for cash sales.

Debtors.—The figures for the amount of debtors can be ascertained from a summary prepared at the end of the month without extracting the balances in detail, which of course would involve a considerable amount of labour. This summary is made up as follows: Add to the total amount of debtors at the commencement of the month the total sales for the month, and deduct the total cash received, discount allowed, and returns; the balance will be the total amount due from customers at the end of the month. Example—

Debtors 30th June 1909...		£4,160
Sales for the month (July),		
Cash	£865	
Credit	1,485	
	...	2,350
		£6,510
Less, Cash received during month, ...	£2,052	
Discount allowed ...	174	
Returns	89	
	...	2,315
Debtors at 31st July 1909...		£4,195

The debtors would therefore show an increase of £35 for the month.

Creditors.—The creditors are ascertained in a similar way to debtors. Example—

Creditors at 30th June 1909	£2,076
Add Purchases for the month (less returns)	2,005
	4,081
Deduct Cash paid and Discount ...	1,889
Creditors at 31st July 1909	£2,192

The creditors would thus show an increase of £116 for the month.

Bank Position.—This would be ascertained from the cash book, which should show the monthly balance or overdraft carried forward to the following month.

Stock.—The value of the stock is estimated by adding to the amount of stock at the last stocktaking the amount of purchases and manufacturing wages and expenses, and deducting

therefrom the sales (less estimated gross profits). Example—

Stock on hand 30th June 1909		£6,756
Add Purchases (less returns)		2,005
,, Manufacturing Wages		176
,, ,, Expenses		205
		9,142
Deduct Sales (less returns) ...	£2,261	
Less Gross Profit (20 per cent)	452	
		1,809
Stock at 31st July 1909		£7,333

It will be seen, therefore, that the estimated stock can be ascertained for the purpose of these monthly statistics where lists of the stock are not available.

The forms given above can easily be further extended and amplified. In an instance where a business has several departments or branches, the turnover of the various departments or branches would have to be ascertained to show the departmental or branch comparisons, and in the case of firms having travellers or agencies an analysis of the sales of each traveller or of each agency should be obtained.

The books should be so planned and drawn up as to provide for the departmentalising of the business, so that the result of the transactions of each department, whether of merchant or manufacturing, will show that such department (making goods for another department) is paying for itself, by the charging out from that department to the other.

By adopting the system of examining and criticising these particulars regularly and frequently, discrepancies and irregularities are more quickly adjusted, whilst at the same time the weak points of the concern are revealed more prominently, before they have assumed serious proportions, and in addition to this a fair idea can be obtained as to the profit likely to result from the month's trading.

CHAPTER IX.

"CREDIT."

The allowing and obtaining of credit is one of the most important factors in business affairs, without which many businesses could not be maintained owing to lack of working capital. Usually, both the credit allowed and credit received vary proportionately with the turnover.

As mentioned in a previous chapter dealing with debtors, the amount of credit allowed requires constant attention. Often it is found that a customer who is doing a substantial business with the firm is being allowed a longer period of credit than is usual, in which case the arrangements made with regard to his account should be strictly adhered to, otherwise the gross profit on the sale of goods may be neutralised by the loss of interest on the capital locked up in the account. It is surprising how often it is found that the good customers are practically having to pay for the defaults of the delinquent debtors. In addition to the risk of bad debts attendant on

overdue accounts, there is the loss of interest referred to. Supposing, for example, that the gross profit on the sale of an article be eight per cent, and the normal credit allowed is one month, and that a customer trading on the usual terms takes seven months' credit, it will be seen that six months' interest on the account, say at five per cent per annum, has been lost, which, in effect, signifies that, instead of the original eight per cent having been acquired, the profit is only five and a half per cent. The question then to be decided is as to whether this state of affairs justifies the continuance of business with this customer. It is advisable that customers' accounts which are overdue beyond a certain period should be transferred to a special ledger in order that constant attention may be given to them.

With regard to credit received, sometimes a large amount of credit is obtained from one particular creditor, the credit allowed being in fact more than is customary in that particular class of trade; generally this creditor, who is often termed the "*backer-up*," is obtaining a higher price for his goods sold to the firm than the price at which the firm could obtain the same goods in the open market, thus compensating himself for the

increased credit and responsibility undertaken. In these instances, of course, the gross profit of the firm is inclined to be less than normal, owing to the creditor obtaining part of the normal profits by reason of the increased prices obtained for his goods sold to the firm. This system has its advantages, one of which is that a trader who is short of capital is provided with the means of commencing or extending business, and at the same time the probability is that the creditor financing him will help him over any temporary difficulty; the trader has thus someone to depend on when his business is passing through a period of depression. On the other hand, there are disadvantages and contingencies in connection with this system, for, in addition to the loss of profit (which of course can only be expected where there is a lack of working capital), viz., the fact that the creditor is apt to get too much control in the working of the business, to be too exacting, and in case of temporary misfortune is in a position to put pressure upon the business more easily than an ordinary creditor could do, being able to stop supplies, and the account would probably be too large an amount to transfer. To safeguard as far as possible against the many contingencies arising

from the adoption of this method of obtaining credit, it is better, wherever possible, to have an agreement placing restrictions as regards the closing of the account within a certain period, and that in case of the death of the "*backer-up*," or upon his retirement, bankruptcy, insanity, etc., sufficient time will be allowed for payment of the account. There are many methods of arranging these matters, but each case would have to be dealt with according to its particular circumstances. There is no doubt that a limited liability company has a distinct advantage in dealing with many of the difficulties that arise from borrowing money, but this is dealt with further in Chapter XVIII. on "Limited Companies."

In times of depression, every available means is adopted to keep the business together and to maintain the turnover. Selling prices are "cut finer," resulting in a decreased rate of gross profit, and also increased credit is offered.

When trade is bad and turnover decreases, the natural result should be that the working capital required by the business decreases. Thus the English financiers and bankers naturally anticipate, and sometimes demand, a reduction of their cash

advances, and more especially when such cash could be put to better use abroad. In the American financial crisis of 1907 the English financiers became nervous at the state of their finances, and consequently demanded a reduction of overdrafts; the result of this was to restrict trade here, as the facilities for financing an increased trade were not available. This meant that stocks and credit had to be reduced, which resulted in decreased buying and consequently in decreased turnover. It is such influences as these that cause what is termed "bad trade."

CHAPTER X.

"BRANCHES."

It not infrequently happens in the case of a successful merchant or manufacturer, that many inducements and proposals are submitted to him to purchase existing businesses or open branches, but it may so happen that the successful man with one place of business is the unsuccessful man with branches. In the business that he conducts himself, he has grown with it, so to speak, and knows its peculiarities, his employees are accustomed to it, and he is conversant with the particulars of his sales, purchases, and expenses, etc., and practically has them at his finger ends. When, however, he opens branches he is compelled to rely to a very large extent on the returns of the branches; in other words, he has to be a financier, organiser, and merchant combined, and it is in the first two capacities that he not infrequently fails. He charges the goods to the branch in the ordinary way, assuming that the branch will make the same margin of profit that he himself makes, and he

expects the branch to keep stocks clean and watch the credit given with the same keen scrutiny that he himself woul dexercise; in many cases, however, he is surprised to find that what he expected does not happen, and when he ultimately prepares accounts he is more than disappointed at the results.

Probably one of every three branches commenced is successful, the remaining two are unsatisfactory unless a proper system is devised and carried out exactly. The best method of organising branches supplied with goods from head office is to treat the branch as an ordinary debtor, charging it with all goods at the cost or retail price, watching carefully that after the branch has once been stocked that the stock shows no material fluctuations. The weekly returns of total receipts, expenses, etc., from the branches, should be carefully examined to ascertain that the cash received therefrom more than covers the cost of goods forwarded to the branch during the week, the salaries of the manager and staff, rent, and sundry expenses paid out or accrued during the week; for example, assume you have a branch with expenses of rent, rates, and gas, etc., of say £104 per annum (or £2 per week), manager and assistants' salaries £4 per

week, and sundry incidentals £1 per week = total expenses £7 per week; if the branch receives £90 worth of goods weekly (and stock is kept at the same value from week to week) and you require about ten per cent profit, you will expect to receive from the branch in cash about £107 per week (gross), arrived at as follows:—

Goods sent to Branch ...	£90
Rent, Rates etc.	2
Salaries	4
Sundries	1
	97
Add for profit, say	10
	£107

A plan often adopted by well-organised concerns is for inspectors from head office to visit the branches, and value or test the stocks from time to time in order to ascertain and report upon to the head office the condition of the stocks, as to whether there are discrepancies, and whether the values of the branches' stocks agree with the values as shown by the head office books.

In the case of branches that conduct their own purchases and keep their own books, the directors or partners of the firm should meet at least once a month, when the statistics of the trading at the branches should be submitted and discussed. Each branch's figures should be examined as regards the comparisons of sales with the previous years, the amount of credit given and received, the estimated stock comparisons, and the percentages in proportion to turnover.

The capital employed in a branch's business should be enquired into regularly, in order to make certain that the capital employed is not increasing out of proportion to the turnover and profits, and that the profits made at the branch are being remitted to head office in cash.

Briefly, the plan to be adopted is as follows :— The directors or partners at head office should sanction all additions to capital account. Meetings should be held at least once a month at which the reports from the branches should be considered as to particulars of purchases, sales, expenses, bank and cash positions, debtors' accounts outstanding, creditors' accounts, stock, and details of branches' current accounts with head office.

By the examination, critically, of branches in this way, it controls and shows any laxity on the part of a branch manager, as the returns should, with slight exception, agree as regards comparison of the business from various standpoints. It might possibly be supposed by anyone who has not endeavoured to carry out this system that the same involves a great expenditure of time. Experience, however, has proved that firms dealing with matters monthly in this way economise time, as it prevents many misunderstandings and much friction between head office and the branches, and many matters that would require separate journeys, and considerable outlay of time and money are disposed of at the monthly meetings; also books are kept up-to-date owing to the board requiring figures, and the general tone of the firm becomes more satisfactory. It is sometimes advisable to make the manager of an important branch a director of the firm, for it is then possible to divulge to him the state of the firm's finances and the profits of his branch, and this creates in him a feeling of more responsibility, and cements his best endeavours to the firm's interests.

CHAPTER XI.

"Purchase of a Business."

In considering the question of the purchase of a business, or of an additional branch to a business, the intending purchaser will, first of all, desire to know that such business has been and is likely to continue a profitable one, and with a view to obtaining this information, copies of the profit and loss accounts and balance sheets of the business for at least the three preceding years should be obtained. Before making an examination of these accounts, enquiry should be made as to whether they have been audited and certified, for this having been done, of course, ensures the reliability of the figures. Whether the accounts have already been audited or not, however, it is desirable that the intending purchaser should give instructions for an examination of the books and accounts to be made by a qualified accountant before arrangements to purchase are finally settled. After this has been done, the accounts, with other matters relating to the business that must be taken into consideration,

are ready for scrutiny and criticism. Dealing first of all with the profit and loss accounts of the three years, these should be compared minutely in order to ascertain whether they indicate a steady and consistent condition of affairs or not; whether the turnover is increasing, decreasing, or stationary; whether the percentage of gross profit is fairly constant, and such as is usually earned in a similar class of business; and whether the percentages of expenses and net profit to turnover are reasonably consistent. Marked fluctuations should be noted with care and a satisfactory reason obtained therefor. There are many other matters on the procedure of an investigation that would have to be reported on separately according to the circumstances peculiar to the case. When reliable stock and cost accounts have been kept, there exists a valuable corroboration of the contents of the trading account. Any exceptional source of profit should be noted—for example, the proceeds of an important exhibition, or an exceptional contract,—as the primary object of investigation is to arrive at the normal profits of the business.

A point of importance in many cases is as to whether the premises at which the business has been carried on can be secured for the benefit of

the intending purchaser, either under a lease for a sufficient term of years or by obtaining the free hold, for it is easily apparent that a removal might possibly dislocate the business and seriously affect the goodwill. Whilst dealing with the question of goodwill, it is advisable to discover whether the name under which the business has been carried on can be retained. Impressions should be formed and opinions arrived at as to the manner in which the business has been conducted and as to the *personnel* of the management. Where travellers constitute a material part of the goodwill of the business, it is particularly essential to ascertain whether the services of the travellers can be retained for a period of time.

The amount of capital required to conduct the business on similar lines as in the past and the probable return on such capital should be estimated, consideration being given for the fact that capital expenditure will be necessary for the purpose of advertising, experimenting, additional buildings, or machinery for more economical or increased production.

The prospective purchaser should know to what extent the continued success of the undertaking

depends upon (*a*) successful competition, (*b*) the continuance of a monopoly, and (*c*) the caprice of public demand. Briefly, what he requires to know is, "What are the prospects of the venture?" The above points are necessary questions, answers to which will indicate whether the purchase of the business is worth further consideration. The next question to be considered, if everything is satisfactory, is the price. Assets such as buildings, stock, book debts, horses, carts, machinery, plant, tools, patterns, etc., might be taken over on valuations, preferably those made by a competent valuer and an accountant.

The value of the goodwill must necessarily depend upon particular circumstances. It is usually based upon a certain number of years' purchase of the average net profits of the business, but is affected by the following:—

(*a*) Necessity for skilled supervision;

(*b*) Amount of capital required to conduct the business and the risk involved;

(*c*) The precise nature of the business and whether the goodwill is attached to locality, personality, reputation, or connection;

(*d*) Declining business or a declining locality;

(*e*) Continuance of the services of the vendors and their servants;

(*f*) Competition of the vendors, or whether the latter can be reasonably restrained.

Purchasing the goodwill usually means that the right to use the old firm's name is retained by the purchaser, and that the vendor is debarred from soliciting the customers of the firm, though of course such customers might follow the vendor of their own accord.

The price of the goodwill of a trading concern varies usually from any amount to about four years' purchase of the net profits, but it may even exceed this.

CHAPTER XII.

"Specialisation in Business."

The art of specialising in any particular class of business becomes more apparent and essential as each year passes. It is almost beyond the comprehension of any one mind to understand the complicated details and be aware of the pitfalls of many varied classes of businesses, and at the same time to keep pace with competitors who are specialising in only one distinct class of business. The competitive system of conducting businesses to-day shows a tendency to increase, and it therefore is incumbent upon one to devote energy and thought to a particular class of business to which one is able most easily to adapt oneself. A man may have been successful in one particular line, with which he may have been connected for many years, still it does not in the least follow that the same success will attend his efforts in a business of a different character that he may have an inclination to undertake. On the contrary, it is often proved that failure over-

takes many of those who embark on businesses which they do not thoroughly understand, and which are dissimilar to the business or businesses in which they have already specialised.

Similarly a man may have been employed, and perhaps have been an excellent salesman or a very valuable employee, and probably have saved or perhaps inherited some amount of money, and he considers that the time is opportune to embark into business on his own account. He lacks the knowledge of systematic principles, and has no organising abilities so necessary for the head of a business, and he is marked out, as a consequence, for failure. Particularly is this the case with small shopkeepers, so many of whom become practically failures, mainly through ignorance of their financial positions. They seldom prepare balance sheets, leaving that to the Official Receiver when the smash comes. The two main causes of such failures are really (1) neglecting to keep proper accounts, and (2) the unwise method of withdrawing money from time to time from the cash receipts without any note of same being kept. The first of these is dealt with in Chapter XIII. on "The Necessity of Keeping Books," and the second in Chapter XX. on "Office Organisation."

CHAPTER XIII.

"Necessity of Keeping Books and the Value of Figures."

"Books are made for Business, and not Business for Books."

A mistake often made is to endeavour to conduct a business with a memorandum book or even without books at all. This lack of system may have been sufficient in days gone by, but commerce has now reached such a stage, and the differences between cost and selling prices are reduced to such a small margin, that the need for constant reference to figures and the necessity of having reliable statistics makes the keeping of correct records indispensable to the successful conducting of almost any business concern. Seldom a day passes but what one can read of proceedings in bankruptcy as the result of no books having been kept, or where the books kept have been of little use in so far as they disclosed the debtor's position or the result of his trading. A good system of bookkeeping would,

in these instances, have acted as a guide, and would have amply repaid any slight additional expense and trouble, and would at the same time have prevented many mistakes, and would have assisted in avoiding much confusion and petty worries associated with and attendant on the non-keeping of proper books of account.

There is a confidence and a sense of satisfaction in doing a thing correctly and systematically, for as a consequence the results can always be depended upon. The value of a good system of book-keeping is that the principal is able to glean from it sufficient statistics to enable him to point to any defective part of the trading or to any weakness in the management, and having detected the imperfection to at once be in a position to find out the remedy. Defects can be adjusted which might otherwise be continued and finally end in misfortune. It is more than surprising what is revealed by statistics often when quite different results are expected.

If a good system of books has been in use and correct figures of the trading obtained therefrom, the principal is able at a glance to grasp the position of affairs and see (1) whether the turnover

is up or down; (2) the margin between the cost of production and selling prices; (3) whether the prices he obtains are too high or too low; (4) the percentage of wages he pays for the production of the goods he sells; (5) the amount he pays for fixed expenses and for expenses that fluctuate with the turnover; (6) the percentage of the expenses in proportion to the turnover; (7) whether the expenses are too high, and, if so, where they can be reduced; (8) the percentage of net profit on his turnover and on his capital employed; (9) whether his stock is being turned over sufficiently; (10) whether his debtors are too high in proportion to the turnover, showing that too much credit is being allowed, and, following this further, finding out which of his customers are behind in their payments; (11) whether discounts receivable are being obtained; and (12) whether too much is being allowed for discounts to customers.

Reliable and very necessary information of this description can only be satisfactorily obtained from a correct set of books, therefore the latter is essential to the successful business man of the present time.

CHAPTER XIV.

"Profits and Insurance against Loss by Fire."

"Nothing should be left to chance that can be guarded against by forethought."

In addition to the well-known classes of insurance, such as fire, life, accident, workmen's compensation, burglary, etc., there is another important class which is not so well known, namely, insurance against loss of profits occasioned by fire.

Security of capital and security of profits are the essentials of every sound and successful undertaking. In case of fire both these may be maintained by insurance.

The statement that most of the trouble in this world is caused by the dread of possible disasters rather than the presence of actual calamity is an axiom shrewdly stated. Undoubtedly, insurance

reduces these worries, and should be considered wherever practicable. Material damage, however fully indemnified, leaves the business more or less in a state of disorganisation, hampering the rate of production, whilst, during this period of crippled resources, fixed charges (*i.e.* interest, rents, etc.) still remain to be met, and extraordinary expenses (*e.g.*, increased cost of production, new premises, etc.) accumulate. Whilst the reorganisation following the fire is proceeding, rival firms secure a firmer standing in the market, and the business of the fire-damaged firm deteriorates, so that when it is restored to full working order it has once more to capture many of its customers from rival houses. The exact science to which insurance has now been raised makes that contingency capable of direct and simple provision under a scheme of insurance. In the short space at disposal for this subject, it may be briefly mentioned that this form of insurance covers loss of profit, payment of standing charges, and increase in cost of working due to partial or total interruption of business or stoppage of work caused by fire, etc.

The basis of the settlement is usually that of the annual turnover, but it may be on the output

in yards, tons, gallons, etc. Based, as the premiums are, upon the rate per cent paid for the ordinary fire insurance covering the premises, and assessing the loss of profit after the fire on the basis of the normal turnover or output of the business by the independent examination of a mutually-appointed qualified accountant, the simplicity of the scheme and the settlement is equalled only by its equity.

CHAPTER XV.

"The Advantages of an Audit."

The advantages of an audit are both direct and indirect; direct in so far as they immediately affect the completed accounts and the results shown by those accounts during any given period, together with the organisation in connection with the preparation of those accounts; and indirect in so far as they influence transactions in which an accurate statement of accounts is largely a determining factor as to the final decision arrived at.

Dealing first with the DIRECT ADVANTAGES, these may briefly be enumerated as follows:—

(1) Detection of clerical errors.

(2) Detection of errors of principle.

(3) Prevention of fraud.

(4) Work kept up to date, thereby saving principal's time.

(5) Efficiency of system employed.

(6) Accuracy of accounts.

Taking these advantages seriatim—

(1) Detection of Clerical Errors.—Little need be said in this connection, as it will be apparent that these become less frequent as the system becomes more complete, and since it is the aim of every auditor to secure that things shall automatically "balance," the risk of such errors is almost, if not entirely, obviated in the majority of cases where the books are regularly audited.

(2) Detection of Errors of Principle.—These present a far more serious complexion than the mere detection of clerical inaccuracies, since it is impossible to discover them by any automatic means. The "man in the street" probably never thoroughly appreciates the value of skilled knowledge necessary to ensure not only an arithmetically correct statement of accounts being prepared, but also the application of thoroughly sound principles being brought to bear in their compilation. Yet, surely, it will not be denied that this is one of the most important branches of work that come within the scope of the auditor's duties. When one takes into consideration the fact that accounts are not prepared by those skilled in this special department on mere academic lines, but are

in each particular business made to correspond as nearly as is reasonably possible—taking into account the needs of each individual case—with the actual facts, it will be seen how important a matter it is that the greatest care should be exercised in the preparation of statements which are, in reality, a collection of facts showing in a summarised form the actual position and dealings of the undertaking. It will be seen, therefore, that the auditor will naturally make it his special care and consideration to ensure that all transactions are recorded, so as to be in accordance with sound principle and good judgment—an advantage that does not need words to commend it.

(3) PREVENTION OF FRAUD.—Distasteful as this department of auditors' responsibilities may be, yet it is none the less an important and necessary evil, as will be readily admitted if one simply looks through the columns of the daily newspapers, where one is forced to notice that it is absolutely essential that some safeguard must be provided against the dishonesty of unscrupulous employees. In the majority of cases the mere fact of the presence of the auditors will be sufficient to deter those who would otherwise be weak enough to abuse their position at their principal's

expense from committing a fraud—an advantage in itself well worth considering,—but there are those whom nothing will prevent from practising dishonesty except exposure, and it is as a means of effecting such exposure that the auditor's services are so valuable and his expert knowledge of so much assistance. The discovery and prevention of fraud must therefore of necessity occupy a very important place in the advantages to be derived from an audit, especially as it establishes a relationship of mutual confidence between employer and employee, which could never exist to the same degree were there no audit.

(4) Work Kept Up to Date.—The presence of the auditor unconsciously compels those responsible for the office management to keep the work up to date, and especially is this the case when the audit is what is termed a continuous audit. At the end of the year or half-year, it ensures that there shall not be an unduly lengthy period elapsing before the accounts are ready, and thus any discrepancies can be gone into and any irregularities remedied earlier than would be the case were there a long delay between the stocktaking and the making up of the accounts, to the great advantage of all concerned.

(5) Efficiency of System Employed.—System, to a reasonable degree, is the keynote of success in office management and organisation, since, if it be complete and efficient, it eliminates all unnecessary and superfluous detail, whilst at the same time ensuring a record, in an orderly and systematic manner, of all transactions in connection with the undertaking so recorded as to exhibit at once their exact nature and the circumstances connected therewith. From this it will be readily appreciated that there may be many systems in vogue, all good in themselves, in various classes of business, each differing in matters of detail as is found necessary in the particular case to which it is applied and in the varying circumstances to which it has to be adjusted. It is, therefore, no easy matter to decide what is the most advisable system on which to place a set of books so as to ensure the *maximum* of good results being obtained with a *minimum* amount of labour. The auditor who is in contact with different classes of undertakings is naturally the most competent person to judge whether full advantages are being derived by the application of methods most suited to the particular conditions of the business under consideration, and he will

make this his first concern in taking up the conduct of an audit, and therefore it takes a no mean place and is no small factor to be considered when one is deciding as to the advisability or otherwise of introducing an audit into the arena of business organisation.

(6) ACCURACY OF ACCOUNTS.—This has already been dealt with under the heading of "Detection of Errors of Principle," but it cannot be too strongly impressed on all concerned as to the necessity of having one's accounts so presented as to show, in a clear and lucid manner, their exact significance to all who may have cause to examine them, and the training of the professional auditor naturally fits him to advise his clients exactly as to the proper method of stating those accounts so as to ensure that they shall be easily comprehended by all concerned.

INDIRECT ADVANTAGES.—The indirect advantages to be derived from an audit are many and varied, and it is impossible to enumerate them fully in a work of this nature, but merely to give a brief outline of the manner in which the existence of an audit influences, to a very large extent, transactions and undertakings of all descriptions.

Although it is true that limited companies are bound by law to employ auditors, yet, since the acts have never provided that the person to be employed must possess any qualification to enable him to perform the onerous duties (for undoubtedly they are duties involving great responsibilities) which fall to the lot of the auditor, it has, in too many cases, become merely a nominal fulfilment of the law, a state of affairs deplorable as it is unsatisfactory, for the evil becomes increased by reason of the compliance with the legal obligations imposed, whilst all the safeguards and advantages of a thorough audit, performed by competent men, are entirely lost. In writing the following remarks, it has therefore been assumed that by "audit" is meant an audit conducted by those whose professional standing and integrity of character are beyond question, and not a mere attempt to keep within the letter of the law without in any way fulfilling the moral obligations that it is essential must be fulfilled if the audit is to be anything more than a mere farce.

The advantages to be derived from having fully-certified accounts in cases where it is desired to convert a private undertaking into a limited company, cannot fail to be appreciated; and

especially will this be the case where the conversion is of a public nature, when it is almost imperative, if it is desired to gain public confidence, that the names of auditors whose ability is beyond question should appear at the foot of published statements, thereby ensuring to the prospective subscriber that the basis upon which he makes his calculations is to be relied upon—a fact which greatly enhances the possibilities of the success of the issue. That an auditor's duties in this connection will be the more easily and efficiently performed if it has been the custom to have the books regularly audited needs no explanation, and that it will go a great way to enable him to give a certificate calculated to win public confidence is likewise self-evident. These same remarks will apply in the case of a further issue of shares, or when it is sought to issue debentures.

Then again, in the case of amalgamation of two or more concerns, the interest of the old shareholders in the new company would be greatly prejudiced if certified accounts were not available, proving the accuracy of the statements made as to profits, etc.; whilst on the other hand, where such accounts are produced, the shareholders' interest in the new company will be very advantageously

affected by reason of the fact that reliable figures are to hand—a most important factor in arrangements of this nature.

In the case of the sale of a business, the fundamental considerations of a purchaser will be: What is the profit that has been earned? Has such profit been increasing or decreasing? Has it been subject to violent fluctuations? Has it been produced at a minimum outlay of expenditure? etc. Now, although these considerations consist of facts, yet a purchaser will naturally take into account the sources from which such facts have been derived in order to ascertain their reliability. It is, doubtless, well known that in many such transactions he will employ his own professional accountant to investigate the figures laid before him, and will, in a large measure, act upon the recommendations put forward after such investigation. It will, therefore, require no very great stretch of imagination to understand that, if the accountant so employed has reliable data on which to work, not only will it save him a magnitude of detailed scrutiny, but will create in his mind a confidence that will be reflected in the recommendations made to his client, which will eventually enhance the purchase price to the vendor. Undoubtedly, the most

satisfactory way of convincing the investigator that the figures put before him are what they are represented to be, is to be able to inform him that it has been the custom to have the books regularly audited, and to be in a position to produce signed accounts if called upon to do so. Such a state of affairs must of necessity be conducive to a great saving in time and patience, for the firm's auditors could be (and, in the majority of such transactions where auditors are employed, are) dealt with direct, and, since they would have all information at their finger ends, they would be in a position to satisfy all the requirements desired, and, from their professional training and experience, to intelligently answer all interrogations to the mutual satisfaction and advantage of both vendor and purchaser, thus creating a confidence which plays a very important part in the final fixing of the purchase price.

The same considerations will apply in the introduction of an outside partner, and it will very easily be appreciated how imperative it is that mutual confidence shall be the governing spirit prevailing from the very outset, that no loophole shall be left through which the evils of suspicion can enter with their attendant injurious consequences, but that the partnership relations

shall be placed on a footing of perfect trust as being the only means by which satisfactory results can be obtained. That partnership difficulties and differences are bound to arise, despite the most carefully drawn up articles, is a fact which experience shows to be only too true, yet such disputes are reduced to a minimum where an audit is conducted and accounts presented regularly, especially as all the partners concentrate, so to speak, their confidence in the auditor to see that the rights of partners, *inter se*, are properly adjusted and in accordance with the articles. In fact, the likelihood of any disagreement on the rights of partners between themselves is practically eliminated where an auditor is employed, since his expert advice will, in the majority of cases, be acted upon, and it is chiefly on matters of management, which are outside his scope, that disputes are most likely to arise.

Then again, on the death or retirement of a partner, where certified accounts have been prepared regularly it becomes quite an easy matter to ascertain the deceased or retiring partner's interest in the concern, and especially will the advantage of this be appreciated where it is necessary to arrive at the amount of the interest in goodwill to be

credited to such partner's account. Also, on the dissolution of a partnership, the same remarks will apply.

Nor are the advantages to be derived from an audit by any means confined to limited companies or partnership concerns, but are just as applicable to the private undertaking of the individual. Apart from the fact that he may, at some future date, wish to convert the business into a limited company, or may be desirous of disposing of it privately (in which cases the arguments in favour of an audit have been already put forth), in the event of the death of the proprietor, the difficulties which beset those entrusted with the management of his affairs will be in a large measure removed where auditors have been employed. This is the more apparent since the auditor can be called upon to give any necessary information which his knowledge of the accounts renders him able to afford. That the difficulties which surround the position of the executor or administrator are becoming increasingly perplexing, by reason of legislative requirements, and the duties devolving on them, for the same reason, are becoming more onerous will be denied by none who has undertaken the responsibilities; and it is a matter for regret that

more do not recognise that, by the adoption of the means stated above, the way may be considerably smoothed for those acting in the representative capacity of executors or administrators. That the revenue authorities are desirous of exacting all they possibly can in the way of death duties is perhaps only natural, but that they should be able to levy more than is due to them, by reason that proper accounts cannot be produced verifying the accuracy of statements made (particularly in connection with such assets as goodwill), is a matter that is far from satisfactory from the taxpayers' point of view, especially when, had proper steps been taken at the right time, it could have been entirely obviated. It must be borne in mind that there is no difficulty in prevailing upon the authorities to accept figures prepared by recognised professional accountants, whereas, where such certified figures cannot be produced, the inquiries will naturally be more stringent, and will often result in overcharge without any remedy but to "pay."

The above remarks also apply to the assessment of income tax. It is the common experience of professional accountants to find that in going on a new audit, the principal has been over-assessed,

sometimes to a no inconsiderable amount, by reason of the fact that (1) proper accounts have not been prepared, (2) he has not the expert knowledge to enable him to take full advantage of the laws operating in his favour. In cases where auditors are employed, it is very largely the custom to leave the income tax matters in their hands, and since the accounts of any firm of auditors of any standing are always accepted by the authorities, and they bring to bear their knowledge and experience in such matters, the risk of overcharge is reduced to zero—a state of affairs most satisfactory to the taxpayer living in a day when one can hardly set up a newspaper stall without being instantly involved in a labyrinth of tax law. Again, in cases where accounts have been certified by auditors, but where the client has prepared his own income tax return, should he, by any chance, have suffered overcharge, there will be little difficulty in obtaining a repayment of the amount overpaid, by reason of the fact that his past accounts will be accepted, thereby substantiating his claim.

It not infrequently happens that in the financial management of a concern it is necessary to obtain an overdraft from the bank, or a loan, upon proper

security being given. That the efforts in this direction will be considerably enhanced where an auditor's certificate is produced, authenticating the statements made, is a matter of common knowledge, and should not be lost sight of when considering the advantages of an audit.

Turning to the internal management of a concern, it will be seen from the previous chapters that reliable accounts are a most satisfactory and necessary adjunct to commercial finance, for not only do they form the basis upon which past results are criticised, but also form the foundation upon which future calculations are made. In this connection it will readily be seen that periodical statistics must, of necessity, play a very important part, and it is here that the auditor's services are particularly useful, for whilst advising as to the form, etc., in which such statistics are to be presented, he is in a position to verify their accuracy and to draw deductions which, when submitted to his client, form a very useful addition to his statistical memoranda. Again, in the matter of costing, it is probable that the advantages of an audit in connection with the internal management are most apparent, for it is upon the accuracy of the costings that the realisation of the anticipated

return depends, and therefore the auditor will naturally make it one of his first duties to see that an adequate and thoroughly reliable system is in operation, and will, from time to time, ascertain whether the expected results are being realised.

The foregoing remarks, though by no means exhaustive, are sufficient to show that an audit forms an integral part in the organisation of all undertakings where thorough efficiency is aimed at, and that it is as inherently inseparable from completely equipped organisation as credit is from the business relations of the commercial community.

CHAPTER XVI.

"TRAVELLERS."

There is no doubt that a complete and satisfactory method of dealing with and superintending travellers requires a considerable amount of thought and attention. Some firms are constantly encountering difficulties with their travellers, for although a man may perfectly understand all about his business, the study of men is perhaps a matter to which no great amount of time has been given by him. It is not alone sufficient to understand one's business if extension is intended, but also the best ways and means must be considered of securing from others almost the same amount of work that one can do oneself. In no instance is this more necessary than when dealing with travellers—those whose duty it is to secure orders. The result of a traveller's efforts should be that more assistance is required at headquarters to cope with the increased business. Many firms instruct their travellers to report daily to them even when they have no orders to send in; the

position is soon realised that what is wanted is *orders* not excuses, and that goods are being made for which orders are needed. A good salesman is like a good cook—he can create an appetite when the buyer is not hungry; it is a much easier matter to supply an existing appetite. The travellers should be encouraged to forward any new ideas and methods they think of, or come in contact with, to the office. No matter how good old methods are, new ones are often better. Customers want things up to date, and if one firm cannot supply them they will find another firm that can.

Some companies make their best travellers directors, giving them a proportion of the profits. This undoubtedly creates in the travellers a sense of responsibility and interest, and is, as a consequence, more likely to produce good results.

A good traveller is a man who is not easily replaced, and it is therefore necessary to use every possible means to ensure that one's trade runs no risk of being taken to a rival firm. To be on good terms with one's best travellers, then, is most necessary.

Advertising, although closely connected with the duties of a traveller, is a matter that requires separate treatment and expert attention in order to be efficient. But here again suggestions by the travellers should be welcomed. One can easily *waste* money by advertising, and what is wanted is to *make* money by it. The head of a firm cannot be in very intimate touch with his customers to know just their wants, and a good traveller should ventilate the suggestions he thinks would overcome the complaints he hears of, and send to headquarters his observations for the purpose of improvement to the advantage of the business. Experience has proved in some cases that it is advisable to go for the consumer by advertising, and create a demand for an article instead of constantly soliciting orders for it.

There is also the question as to the advisability of having a superintendent of travellers, to keep in close touch with them, watch their journeys, orders, prices, expenses, cash settlements, etc. If a traveller is collecting accounts, care should be taken to see that his settlements are made on the appointed days. If he is giving receipts, these should be given out of a carbon duplicate receipt book, and the book daily, weekly, or fortnightly

forwarded to the office to be checked, or forwarded when full for checking over with his returns. In order to prevent peculation on the part of travellers, statements should be sent out from the office periodically to the customers, or if possible the travellers' grounds should be inspected from time to time. This question is dealt with more fully in Chapter XX. on "Internal Checks."

It is often desirable to obtain suitable guarantees for a traveller's fidelity.

CHAPTER XVII.

"Bad Debts."

Bad debts are a serious charge against profits, but at the same time, competition being so keen in many businesses, one is forced to the conclusion that most firms have to be indulgent with many of their customers, although of course there must be a limit to this indulgence. The first point to be considered in this connection is the amount of gross profit; for instance, in the drapery business, furnishing business, ironmongery business, and other businesses where the rate of gross profit is usually substantial, more risk of bad debts may be taken. Conversely, in businesses where the percentage of gross profit is small, as, for instance, shipping or auctioneers' businesses, bad debts will have practically to be an unknown

quantity. Bad debts often occur unexpectedly and collectively, and it is inadvisable to take one year only into account when considering this question, as it might so happen that the bad debts in one year are only half per cent on the turnover and the next year two per cent. It is therefore necessary that a three to five years' average percentage be taken in estimating losses by bad debts. Often the effect of restricting the credit allowed is that the turnover is reduced, and consequently the amount of gross profit decreases. The question to decide is, what amount of losses on bad debts can the business afford in view of the amount of gross profits? Where the percentage of bad debts in a business is very small, it may be that the turnover is being restricted, and that by being a degree less stringent on the question of credit a larger turnover might be obtained, and as a consequence larger net profits. For instance, supposing that the existing turnover be £25,000, and that by being easier on the allowing of credit an increased turnover of £5000 resulted, and assuming that the rate of fixed expenses, say 15 per cent, remained stationary—

The extra net profit would be (15 per cent on £5000)	£750
And the rate of bad debts, 1 per cent on £25,000, had increased to 2 per cent on £30,000, the additional loss (occasioned through less stringency as regards credit) on account of bad debts would be	350
Showing an increase of net profit of...	£400

Thus it will be seen that, although more bad debts have been made, yet, with the increased turnover consequent on greater leniency being given to customers' accounts, the net result has warranted this procedure.

CHAPTER XVIII.

"ADVANTAGES OF A PRIVATE LIMITED COMPANY."

A business man, after many years of anxious thought and tireless labour expended in the building up and making of a business, sometimes considers the desirability of transferring a large part of the responsibility of the concern to others, whilst at the same time he does not wish to lose all touch with a business that, by his energy and perseverance, he has established. Possibly he may be desirous of bringing others into the concern (as, for instance, his sons or managers), and give them an interest therein, and thus, at the same time, improve the organisation and standing of the business. There are many points of difference between a private partnership and a limited company, but the advantages of the latter, particularly where a man does not want to risk the whole of his fortune in his business, are unquestionable. This chapter is written with a view to pointing out these advantages and to give

some suggestions on the schemes put forward for conversion of concerns into limited liability companies.

A limited liability company can adapt itself to present-day business organisation better than a partnership can, and the word "limited" attached to a firm's name implies to the public that the business is more extensive, also the name "director" carries more weight and gives the impression of greater importance than does the name "partner."

In a partnership a partner with a small amount of capital, say £500, would almost equal in influence and authority a partner having capital £5000; whereas in a limited company the power would be by votes, and the senior director, having £5000 would have 5000 votes, against a junior director, having £500, 500 votes; that is to say, each member would have one vote for each share held by him. This means that the shareholders having the largest number of shares have the greatest power, but at the same time the rules of the company bestow upon the other directors powers and duties that assist in securing the best endeavours from them,

and they would be subject to the governing director's decisions.

The individual liability in a partnership is unlimited, whereas in a limited company the liability of the member extends only so far as the amount of capital invested by him, and the risk therefore is, of course, limited. Consequently, private assets are safeguarded, and creditors have no legal right to retrieve their losses by encroaching on the other investments or private assets of the members of the company. Again, in a partnership there is the liability for a co-partner's partnership dealings to be considered, and this liability also is practically unlimited.

In a limited company the position of the firm is put on a more consolidated form, so that in case of retirement, death, insolvency, etc., of any member of the company the position of the company is not affected. In the case of retirement it is merely a question of negotiation between the members of the company and others *privately*, and does not affect the capital of the company, and the director so retiring might easily arrange that, although he retired from active management, he should still

act as the chairman or director of the company, attend the meetings, and retain his voting power during his lifetime, and authority could be taken to do this in the articles of association, which are the rules of the company. In case of the death of one of the members of the company, the advantages of a limited company are again apparent. No stocktaking is required; the executors have a free hand; they may sell the shares, but this does not affect the capital of the company—they can only transfer the capital.

A limited company lends itself to the making of a satisfactory will, and it is an open secret that there is seldom one will in four that runs easily. Circumstances alter, so that many times the circumstances at the date of death are entirely different to those that existed at the date of the making of the will. If no provision is made to carry on a private business under the will, of course the executors cannot continue it; not only so, if powers are given in the will, circumstances and contingencies may occur or be existent that may make the executors nervous of acting, and they, naturally, not being financially interested themselves, run the least risk by disposing of the business, for they always run the risk, when

trading, of being personally liable to pay the creditors for any goods bought; in fact, the leaving of a successful business for executors who may not know the details of its workings is a very great risk.

In the case of a limited company, it is a very simple matter. The will merely says—"I leave 5000 shares in A. B. C. Company Limited to my son John Smith, 3000 shares in X. Y. Z. Company Limited to my son Charles Smith," and that is all that is required, and it saves executors an immense amount of trouble in proving the will, whilst it ensures the continuity of the businesses in which the deceased was interested. Many an unlimited private concern has had to be wound up or sold because the capital has been withdrawn simply through a defective will, or where there has been no will at all, when, had the company been limited, such trouble would not have arisen.

As regards insolvency, partners sometimes become interested in outside ventures and become bankrupt, but in case of a limited company this would affect the director personally and not the company.

Amongst other reasons for the advantages of a limited company may be stated :—

(*a*) Cash can only be paid on profits earned, and this is an incentive to business and prevents withdrawal of working capital, this latter being a practice which impoverishes so many private concerns and partnerships.

(*b*) That a limited company prevents in no small degree any laxity, as the articles provide for proper organisation, and define the rights and duties of each director, *e.g.*, "that the governing director, who holds the largest number of shares, shall have control," and full arrangements are provided for other directors in succession.

Thus, whilst a principal director is in the business, the articles would state that he was to be the governing director, and after his retirement or death another managing or other director would step into the position of governing director and take control.

Again, should additional capital be required at any time for the purpose of further extension of the business, or for any other purpose, securities could be given to persons willing to lend money to the concern in the way of debentures charged on the company's properties, and persons ready to risk a certain amount in the undertaking without incurring any further liability can take shares, and by paying for them in full be free from any further risk.

Take as a basis an imaginary balance sheet, as under, and the following scheme will perhaps be both interesting and explanatory :—

LIABILITIES.		ASSETS.	
Trade Creditors	£8,000	Debtors ...	£10,000
Loans	2,000	Furniture and Fixtures...	300
Capital	10,000	Stock	9,500
		Bank Balance	200
	£20,000		£20,000

In the following scheme assume that the shares issued are ordinary. It is usual, in the case of a

relative or other person interested financially in the business, but not in the actual working of it, to have their interest or share in preference shares, as it gives them greater security but allows the surplus profit to be participated in only by the ordinary shareholders who are working the concern. In this connection, it might be stated that frequently where there are relatives not engaged in the working of the business, it is usual for arrangements to be made by will for them to have their interest only in property, etc., outside the business. This, of course, if the estate is large enough; if not, the best plan would be to issue preference shares, as stated previously.

The usual practice is to float a company, limited by shares, having a capital sufficient to allow of the assets of the firm already existent being taken over and purchased by the new company. The articles of the new company will state the names of the first directors and their respective positions and duties, and usually the articles contain some restrictions upon the sale of shares to strangers. An agreement is next entered into whereby the firm agrees to sell and the company agrees to purchase all the assets of the business,

the purchase money being payable in cash and shares. Thus, taking the assets in the above balance sheet :—

Debtors	£10,000
Fixtures	300
Stock	9,500
Bank	200
	£20,000

These would first be sold to a company for £20,000, payable as follows :—

In cash	£10,000
In ordinary shares	10,000
	£20,000

The £10,000 cash would pay off the creditors and loans, and the new company would pay the expenses incidental to the flotation. Of course, in effect, it means that the business will be carried on in precisely the same way as at the time the business was taken over by the company, and the above is merely a matter of bookkeeping and adjustment to comply with the Companies Acts. The question of loans is a matter that requires

consideration, as, in the case of the death of one director, a cash creditor might not be inclined to continue the loan, or the deceased director might have deposited security with the loan creditor which his executors might be compelled to withdraw, therefore, where there are any cash creditors, this contingency should be considered.

Another matter to be decided upon is the qualification of each director, and in a private limited company it is desirable that the qualification be as large as possible.

In the case of retirement or death of a member of the company, it will be desirable to have a clause inserted in the articles that no share can be transferred to anyone except the wife, child, or trustees of the deceased, or, failing these, the members of the company to have the option of purchase, say on the following basis :—

> At such a sum that will equal the average share of the profit of the deceased, whether distributed or not, for the four preceding years multiplied by three, thus :— Assume that a retiring director's share of profits be—

First year	£200
Second year	300
Third year	500
Fourth year	400
	4)1400
Average	£350

Three times £350 equals £1050, which would represent the purchase price of shares, and if the said relatives or members do not exercise the right to purchase, then the retiring or deceased member's representatives can sell to whom they please, but not at any less sum than £1050 without offering them, in the first place, to the relatives or members of the company at such less sum.

The question that prevents many firms from being transformed into limited liability companies has been the cost; but this, compared with the attendant advantages, is slight, and circumstances that do not lend themselves to private or unlimited businesses arise, sooner or later, in every concern.

CHAPTER XIX.

"INVESTMENTS IN PROPERTY."

To acquire business premises is not always an advantage to a business, and in many cases locks up capital that might be advantageously used in advertising and extending the business. It can, of course, be easily understood that to some shopkeepers (say, for instance, a draper, provision merchant, etc.) frontage and situation of the premises generally represent the greater part of the goodwill of the business, and therefore he would be extremely desirous of owning his own premises to ensure the maintenance of the turnover. One can also understand a manufacturer being desirous of owning his own premises where extensive structural alterations, or specially constructed premises, are required for his particular trade, but in the case of merchants or manufacturers, where almost any premises are suitable, it is a great mistake to lock up capital in unnecessary purchasing of property, unless, of course, the firm has surplus cash that requires investment.

It is possible that, where investments in property have been made, a mortgage has been placed on the premises, and if this should be called in it might very seriously handicap and impair the business. Frequently the annual value of the property on the capital invested only shows a small return, whereas if the same amount of cash had been invested in the business it might have been turned over many times to realise a good margin of profit.

CHAPTER XX.

"Office Organisation and Internal Checks."

In a system of internal checks the essential points to be watched are, first, that wherever possible the clerk in charge of the cash should not be in charge of the trade ledgers; second, that each individual ledger should be balanced separately; third, that the clerks in charge of the trade ledgers should be changed about from time to time, so that any irregularity may soon be detected. The head of the office should be responsible for the carrying out of the clerical work, which, it is generally advisable, should be arranged on the following lines :—

1. All cash received to be paid into bank daily.

2. Counterfoil receipt books to be used for all cash received, and a register of such books to be kept.

3 All payments, except petty cash items (say items under £2), to be made by cheque, and vouchers obtained therefor.

4. Petty cash book to be kept by clerk on imprest system, and all payments to be passed by cashier.

5. Cash and bank balances to be reconciled weekly or monthly.

6. An efficient system of paying wages to be strictly adhered to.

7. Sales day book to contain all credit sales, and to be checked from goods outward book or delivery books, and as to price, extensions, and additions. Appro. book to be kept for goods on sale or return. Cash sales to agree with till sheets or duplicate cash sales slips, a register being kept if slips used.

8. Sales returns to be vouched by a principal, as these are the equivalent of cash.

9. Purchases day book to be entered from invoices, which should be checked with goods receiving book, having columns for carriage account and invoice passed. Invoices should also be checked as to quantities, prices, extensions, and additions.

10. Purchases returns to be cleared from goods outward book.

11. All ledgers to be made self-balancing and be balanced monthly.

12. Statements sent to customers to be examined with the books and posted by a principal periodically.

13. Overdue accounts to be submitted to the principal for consideration.

14. Travellers to bank all cash received daily, using counterfoil receipt books for receipts, and reporting to office daily.

15. An efficient system of cost accounts and stock accounts to be in use and adhered to.

16. All letters received by the firm should be opened by the principal, or in his absence by the principal's manager, who will report as to complaints from customers, allowances, discounts, etc., and many other matters that arise in this connection.

The best men in a concern are often secured to the business by an agreement of service, wherein they are usually, for a consideration, bound not to solicit the customers of the firm if and when they leave its employ. Care should be taken in drawing up such an agreement that such restrictions are not too harsh, otherwise a court of law might not uphold them, acting as they may do in restraint of trade.

The use of card and loose-leaf ledgers is often considered in the organisation of the clerical work of a business. There are both advantages and disadvantages in the loose-leaf ledger system. Amongst the advantages may be stated the facility in arranging, indexing, and posting up the accounts, that "dead" accounts are eliminated from the ledger, and only current accounts kept. The objections are the initial cost, the risk of a card being lost or misplaced wilfully or carelessly where a perfect system is not in use, and where the abilities of the clerical staff are not quite satisfactory.

The entire efficiency of a business depends on the several parts working together satisfactorily and harmoniously. Dissecting the various parts

of a business, we find they are mainly comprised of (1) the buying department, (2) machinery and labour productive, (3) labour unproductive and distributive (which includes travellers), office and warehouse staff, and general management, and (4) working expenses. The total cost of production is cheapest when all these are being worked at a minimum of cost, but it is practically impossible at one particular time that each of these units should be extended to the utmost of its limits. The object is, however, that each should be carefully watched, in order that the same may be worked efficiently and economically.

CHAPTER XXI.

"Costings Accounts."

The subject under observation is of such magnitude that it is only practicable here, to deal with it concisely, to point out the necessity and advantages of a good costing system. Every manufacturer requires to know the cost of producing an article for the purpose of arriving at the amount at which he can sell at a profit, and, in same manner, to know beforehand the cost of every contract he may undertake. It has been stated, and very truly, that "an ordinary trading account is a locked storehouse of valuable information to which a cost system is the key." The final results of the costings books should correspond with the trading account.

Costings accounts are essential to a manufacturer if he is to maintain a firm hold on his business. He will desire to know whether a branch is paying or not; whether it is costing him more to produce any article than he could buy it

ready produced. The costing system aids him to become cognizant of and to trace any waste of material, inefficient management, or bad workmanship, etc.

The complete efficiency of a system of costing is indispensable and any extra time and expense devoted to the obtaining of such efficiency is eventually well repaid.

As one kind of business differs from another, so the costings system applicable to one business differs from that applicable to another, yet the main principles are the same. For example, in a manufacturing business the cost of the production must be ascertained in order to fix the amount of the selling price. The cost of the article is made up of the following items of cost:—

1. Cost of raw materials.
2. Wages, productive.
3. Carriage inward on raw material.
4. General works charges, including foremen's wages, power, stores, etc.
5. Expenses of establishment and distribution.

To the amount then arrived at a percentage is added for the margin of profit for the purpose of fixing the selling price. If a profit of twenty per cent is desired, twenty-five per cent of the cost must be added. Thus, if the total cost is £100, twenty-five per cent added would give a selling price of £125, which shows a profit of £25, or twenty per cent on the sale. The expenditure under the first three headings fluctuates with the turnover; the fourth also fluctuates to a certain extent; the fifth item, too, fluctuates with the turnover, but to a smaller extent.

The following remarks should be noted with respect to the five items of cost referred to above :—

1. The purchases of raw materials are analysed to the various departments, and the actual amount used in the manufacture of an article is charged on the cost sheet of that article.

2. The wages are analysed from the workman's time sheets, and the cash value of the amount of time expended on the article charged on to the cost sheet.

3. Carriage inward on the amount of raw material used in the article is charged direct on the cost sheet.

4. General works charges, etc., are not added direct in cash on the cost sheet, but are included as a percentage on the productive wages, or partly on wages and partly on materials. The total cost of the goods ready for the warehouse is now arrived at.

5. The expenses of establishment, etc., are now added as a percentage on the cost of goods as ready for warehouse. The total cost of the goods is thus settled, and at this stage the percentage for profit as stated above should be added. The following example will perhaps make the above clearer :—

PRIME COST.

1. Materials	£60
2. Wages	20
3. Carriage	2
4. General works oncost, 50 per cent on wages	10
Cost at warehouse ...	£92
5. Office oncost, 10 per cent on warehouse cost	9
Total cost	£101
Add for profit, 25 per cent on total cost	25
Selling price	£126

Showing profit on sale, 20 per cent.

The matter referred to of fixing No. 4 partly on wages and partly on material requires separate consideration in each case. It may be generally assumed that works expenses vary more with wages than with materials, and in these cases all, or nearly all, of the oncost for No. 4 should be fixed on wages, and this is more especially the case in a business using both expensive and inexpensive raw materials for the production of similar articles. For example, copper and iron, thus :—

	Copper.		Iron.
Material	£50	...	£10
Wages	10	...	10
Prime cost	£60		£20

If oncost, say 20 per cent for No. 4, is added on prime cost, the copper article is charged with £12, and the iron £4, although in reality there would be little difference between the two as regards space occupied, power, foreman's supervision, etc. The fluctuation of the price of raw material would also affect the oncost, so that this method is not satisfactory, the cost of labour being the more correct basis.

CHAPTER XXII.

"INVESTMENTS."

In dealing briefly with this subject, it should be noted that the investments here referred to are more particularly cases where a certain sum of money has been accumulated, and it is desired to make it income-producing without any expenditure of labour by the investor. There are, of course, various modes of dealing with this accumulation of capital, *e.g.*, purchase of debentures, ordinary or preference shares in public companies, English and foreign corporation and government stocks and loans on mortgage of real property. Whatever the description or type of investment proposed, however, there are several main outstanding points to watch carefully.

1. The security of capital is the first and most important point to ensure when investing. Without this security there is, apart from the worry attendant upon the investment, the existent possibility of the entire loss of capital.

2. The point next in importance is the income-producing power of the investment, for this is, in fact, the reason for the investment from which an adequate income is desired. The greater the security of capital the less the return of income, also the richer the country in which the money is invested the smaller the yield from its securities. Generally three or four per cents are sound, five and six per cents fairly safe, ten per cents require great care, and beyond that the investment often becomes a speculation.

3. In case the money should at any time be wanted hurriedly for any purpose, care should be taken that the securities have a free market, that is to say, that they may be readily realisable. This latter procedure, however, often has an effect on the capital value of the security owing to fluctuations due to market and trade influences, and the manipulation of "cliques" or "rings," or combinations of capitalists. Thus it happens that securities not having a free market show more stability of capital. If the risk of increases or decreases in capital values can be undertaken, widely removed stocks should be chosen. Thus,

trustee stocks which are named by Act of Parliament aim at security of capital, but by being widely dealt in they are subject to large fluctuations and often defeat the very object aimed at by law, viz., security of capital. The averaging of capital increases or decreases of an investment list is another matter that arises in considering the investments of different countries. Often investments are spread over different countries exercising opposite influences. Whilst one country's stocks may depreciate, the stocks of another country appreciate. Thus reliance is not placed solely on one country's trading, and the speculation on one country's future prosperity is avoided. That is to say, "all the eggs are not put into one basket." Similarly, in the businesses in any one country the investments can be spread over risks subject to opposite influences; for when the weather is fine and bright drapers and outfitters, etc., reap the benefit, whilst in a rainy season umbrella and mackintosh manufacturers benefit.

Great care should be taken when investing in companies where the management is known or is suspected to be not of the best, where the

company is a one-man concern, where the monopoly of the company is subject to the caprice of public demand, and where the prospects of that particular class of business are not too good. Also "cliques" in company management should be avoided, as one section of shareholders might be receiving undue benefits, to the detriment of the others.

CHAPTER XXIII.

"Various Matters."

Income Tax.—As the rate of duty has a tendency to increase from year to year, and as the revenue officials are yearly coming more in touch with the trading community, it is incumbent upon income tax payers to make a return of their incomes for income tax assessment, and at the same time to be able to prove by their books and figures the correctness of such returns. The questions of what are allowable as deductions from gross profits and what are not allowable are too numerous to give in detail here, these being matters of separate consideration according to the circumstances of each case. Points that are often overlooked in connection with income tax are the omission to claim the abatements to which one may be entitled or to claim exemption from the tax, also to make payments at the lower rates on earned incomes and to deduct claims for life assurance, to secure repayment of tax deducted from dividends received, even when such dividends

are paid (as is erroneously stated) "free of duty." Mention should be made as regards the filling up of forms sent to the income tax officials. Any form received from the revenue authorities should be quickly attended to, as the omission to do this may cause loss and irritation. A copy of all particulars thus sent in should be kept for reference in the future.

PARTNERSHIP.—Before entering into a partnership, the matters referred to in Chapter XI. on "Purchase of a Business" should be settled and the whole transaction considered from various standpoints. Nowadays, limited companies appear to find more favour than partnerships, as the responsibilities connected with a partnership are thus reduced.

Wherever the responsibilities of partnership are undertaken, it is advisable that an agreement in writing be signed by the partners, setting out the duties and rights of the partners, the amount of capital to be introduced by each, the interest on the capital introduced, share of profits or losses, maximum drawings allowed, remuneration, management, and the amount of attention to the partnership affairs, arrangement as to books and audit

arrangements as to goodwill in case of the death of a partner or dissolution of the firm, and scheme for paying out an outgoing partner's share either by insurance or otherwise. The last point is most important, as a large withdrawal might easily cause the concern to suspend payment owing to lack of working capital. A clause as to reference to arbitration in case of dispute should be included.

WILLS AND TRUSTS.—Great care in drawing a will is necessary, as the conditions at the time of making may not be similar to the conditions at the time when it is too late for any alterations to be made. A beneficiary under the will must not be a witness to the signing of the will. In case of a business, unless there are arrangements under the will, the trustees have not power to carry it on or to employ further capital in the conduct of the same. Trustees are not entitled to remuneration for their services unless specially stated in the will. Investments, unless otherwise stated, can only be made in trustee stocks. In case of a continuing trust, it is advisable to have the trust books certified from time to time by an accountant, as it is just as necessary that the results of a lifetime's labour

should be watched as the savings are watched whilst they are accumulating.

Deeds of Arrangement and Bankruptcy.—Whatever the cause of a man having to admit failure, it is a noticeable, whilst at the same time a regretable, fact that the majority of cases are due to imperfection in the keeping of proper books of account. By reason of this, a man is unable to ascertain his position as he should do from time to time, and if any discrepancies are discovered and rectified in their early stages the business can often be retrieved, but when things have gone too far the result is a suspension of payment and the calling together of creditors. If, at the outset, an accountant or solicitor had been consulted the result would probably have been different, or, at any rate, the procedure under bankruptcy and the attendant annihilation of goodwill avoided. It is well known that the tendency of a trader in difficulties is to struggle on, trusting for better trade or hoping for some better luck. This struggle invariably results in affairs becoming more involved, and is the cause of much bitterness between his creditors and himself. Securities may be given for loans of money that only act as a temporary relief, and the registration of such

mortgaging, affects the trader's credit. Therefore, before it is too late, a trader in difficulties should place his affairs before a professional commercial man whose experience in similar matters makes his advice invaluable, and the result will be far more satisfactory to all concerned.

Agreements of Service.—As an employee may, from time to time, obtain information as to the conduct of the business, it is often desirable to secure him as far as possible to the business, whereby he is engaged for a period of years at a salary or commission which will encourage him to put forth his best endeavours, and at the same time provide that, after leaving the concern, he is precluded from divulging the firm's affairs or from calling on its customers, and a sufficient time is therefore allowed for the alteration and adjustment of the organisation of the business.

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